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SUBJECT: TURKEY SEEKING A COMPROMISE WITH IMF

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Classified By: Economic Counselor Dale Eppler for reasons 1.4 b, d

[1](#)1. (C) Summary: Charge and Econ Couns met November 19 with State Minister for Treasury Simsek to get a readout on the G-20 Summit and GOT discussions with the IMF. Simsek said the G-20 was a "good first meeting," but produced nothing concrete. While G-20 countries were encouraged to take fiscal stimulus measures, Turkey lacks the resources to do so, and there is no global arrangement to help it. Simsek complained of USG unwillingness to help Turkey by providing a Federal Reserve swap line (reftels A and B), leaving it no alternative but the IMF. While the GOT continues to fundamentally disagree with the IMF demand for pro-cyclical spending cuts/tax increases as the economy is slowing sharply, the GOT will offer "some fiscal adjustment" and spending cuts, and hopes the Fund will compromise on the size of the primary surplus in a new agreement. It makes no difference whether the agreement is for a Precautionary Stand-By or a regular Stand-By. Since it is the private sector that needs the funding, not the GOT, Turkey will almost certainly have to draw the money down. End summary.

[1](#)2. (C) Simsek said the G-20 Summit was a "good starting point" that focused on how not to repeat the current crisis. He particularly noted that rating agencies had failed to accurately assess risks ("Lehman Brothers was still AAA rated on the day it declared bankruptcy") and that all financial institutions need to be brought under regulation, but not by a global agency. The discussion at the Summit was general, without reference to any particular country's situation or needs.

[1](#)3. (C) Going forward, G-20 countries were encouraged to take fiscal stimulus measures. While reserve currency countries like the USA can print money, and reserve-rich countries like China can spend down reserves, countries like Turkey that are running current account deficits do not have the resources for fiscal stimulus, and there is no global arrangement to help them. Simsek complained that neither Treasury Secretary Paulson nor U/S McCormick could explain why countries like Norway and New Zealand received Fed swap lines, while systemically important countries like Turkey were left to the IFI's. Simsek said the IFI's are underfunded to meet the needs of emerging markets. He said Japan was talking before the Summit about providing an additional USD \$100 billion to the IMF, but did not believe it had provided the funds yet.

[1](#)4. (C) With markets still constrained, Turkey needs greater US dollar liquidity, which is why Turkey approached the Federal Reserve about a swap line. Turkey is a major economy with good macroeconomic policies, according to Simsek, and the GOT does not need any external financing next year. The

liquidity concern is over the significant FX liabilities of the Turkish corporate sector. Simsek noted that not all of this debt is coming due soon -- the average maturity is 3.5 years. But "fear is contagious." The liquidity squeeze is the result of everyone simultaneously positioning themselves for the worst possible outcome by trying to stay liquid. Turkish banks and corporates are profitable and able to make payments, so it is a question of confidence and uncertainty. If corporates cannot rollover their FX debts, it will impact the banking sector and ultimately the Treasury.

15. (C) Simsek complained somewhat bitterly that the USG's "unwillingness to help us" via a swap line leaves the GOT no choice but the IMF. The IMF wants substantial, pro-cyclical spending cuts and/or tax increases in a new program, even though the economy is slowing down sharply (see reftel C). The GOT "fundamentally disagrees" with this approach given that the crisis is global, not just in Turkey. The only virtue of the Fund's approach is that it prevents the GOT crowding out the private sector in credit markets. The flaw in the Fund's approach, said Simsek, is that it assumes that enough private sector money will follow the Fund into Turkey to meet Turkey's FX needs. But even if Turkey made all the spending cuts the IMF wants, there is no guarantee at all in the current environment that the private sector will follow. "If Turkey cannot get foreign exchange, our current account deficit will drop to zero."

16. (C) Despite its disagreement with the IMF's approach, the GOT can "do some fiscal adjustment" and will offer some spending cuts to the IMF in an attempt to reach a compromise over the size of the primary fiscal surplus needed to reach a deal. He gave no details on what type or size of cuts the GOT would offer. Simsek said it makes no difference whether the agreement is for a Precautionary Stand-By or a regular Stand-By program. Since it is the private sector that needs the funding, not the GOT, Turkey will almost certainly have to draw the money down. "How can we compete when the Fed and the ECB are guaranteeing corporate debt?"

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